***Please note: This is an AI-generated transcription. There may be slight grammatical errors, spelling errors and/or misinterpretation of words.***

Heather Shanahan:

Welcome. Thank you for joining us this afternoon for Navigating Volatility. My name is Heather Shanahan. I'm the senior director of Endowments and Foundations and part of the Endowment Foundation team here at CAPTRUST. And I'm joined by some of our really astute advisors and investment specialists. They should be a great conversation and we certainly encourage your participation as the audience, both in terms of questions, and then we'll have a couple of poll questions today as well. So I'll start by introducing Chris Kowski. Chris, will you tell us a little bit about you, your background, and where you are?

Chris Krakowski:

Thanks, Heather. Good morning or afternoon everyone. Chris Kakowski. I am a Principal at CAPTRUST. I'm based out of our Chicago office, and I have been in this business for a little over 20 years and that throughout that time I've focused almost exclusively on advising endow foundation, investment programs, nonprofits as well across all sizes.

Heather Shanahan:

Wonderful. Welcome and thanks for joining us, David Sauer.

David Ramsour:

Good afternoon, everybody. I'm David Sauer. I'm based in our Nashville, Tennessee office. I moved here a couple years ago when we opened the Nashville office, but before that I spent about 20 years with our team in Chicago. Along with Chris, I primarily focused on advising endowments, foundations, and other nonprofits such as hospitals with the client base that spread almost from coast to coast.

Heather Shanahan:

Wonderful. We're glad you're here. Thank you so much. Andy Marino, thanks for joining us.

Andy Marino:

Can you hear me?

Heather Shanahan:

Yep.

Andy Marino:

It helps if you unmute. So I'm in our Atlanta office and rounding out the people who work primarily with endowments and foundations. I'm an investment strategist and that is

most of the client base that I speak to and have been doing that for, Chris said two decades. We'll just stop there. You can probably tell by the white hair. It's been a while.

Heather Shanahan:

Wonderful. Thank you so much. And I'm in our Raleigh, North Carolina office. I've been with CAPTRUST for a couple of years and I too have the over two decade mark there in the financial industry, but also have a three year stop out as an executive director of a nonprofit here in North Carolina. So this topic is near and dear to me and I know you're joining us today. It's something that you're concerned about as well as we near the end of 2023 and inflation data should continued signs of easing investors seemingly dismiss the higher for longer interest rate message that we heard from the Federal Reserve for the first three quarters of 2023 with expectations of future interest rate changes seeming less, we saw nearly all asset classes soar and as we enter in the final week of February, stocks are on a high note after the major indices achieved key milestones and registered winning weeks with the help of AI giant Nvidia. But will this AI momentum last as concern around inflation and economic risk lingers taken as a whole? There has been more volatility in the last several years than we've seen in a while. And even though we all know that we should be looking at long-time horizons, not short-term returns, quarterly investment committee meetings and just human nature can make that sometimes a little bit tougher than what we hope and that required discipline difficult. So preparing for volatility means understanding risk and understanding that risk isn't always bad. So let's start the conversation with defining risk then.

And first I think we want to kind of see where you guys are as an audience as we take a look and go to our first poll question. And so there we go. So has the level of return volatility in your portfolio over the last two years been acceptable? Simple yes or no answer here and you should be able to participate in our poll. Alright, it looks like about half of you have voted. We'll give it just a couple more minutes, but it's looking like yeses for the win here. So at this point, 85% say yes, the return volatility in your portfolio has been acceptable and 15% saying no. So let's lean in a little bit and talk about risk. So Chris, on our next slide, there are a lot of different types of risk and for the sake of this conversation today, we're not going to cover all of it and I'm sure everybody's happy to hear that. But let's kind of talk about a few of the major factors here that we tend to see more frequently.

Chris Krakowski:

Yeah, absolutely. Heather, we have a list of some of the key types of risk on this page. There are more here, but I think that the key point is I think there's a lot of risks as an end and or foundation that you have some control over and then there's some risks that you simply can't control. Geopolitical risk, for example, hedging against that is somewhat difficult, but there are ways to construct portfolios to deal with a lot of other risks and frankly, the results of the survey don't surprise me and I think a lot of that has to do with that first line on there. That's market risk. And market risk I would define as just a risk that your portfolio will drop. It obviously could go up too, but what really people focus on in the risk spectrum is that decline in market value due to the overall movements of the market.

And I can't think a better example in recent terms than 2022 and 2023. And again, I think that the reason that those poll numbers look good is because we just came off of a really good year. If you think back to 2022 for example, and you took just a standard 60 40 portfolio, so that's 60% in appreciation assets, think stocks, higher risk assets, and then 40% in preservation assets like bonds, cash, short-term instruments. In 2022, that portfolio declined 16%. It was a really difficult year for bonds, something we really haven't seen before. And so it resulted in negative returns across almost all nonprofit portfolios. But you flip to the next year as Heather outlined in the beginning and in 2023 that same portfolio was up 18%. So you saw a similar decline and then quick rebound back in 2023. So one of the things that we're going to talk about later is ways to identify and mitigate these risks, but really I think from a market risk standpoint, just understanding that this risk is out there and making sure you are prepared as an organization to deal with it is important.

Again, lots of risks on here. One other one I'll point to though that's really I'd say pertinent today is inflation risk. And there's two key issues with inflation risk. One is as a nonprofit, as a foundation or as an endowment, generally speaking, you're looking to exist for a long period of times and in many cases in perpetuity, one of the biggest risks you face is the erosion of the value of your portfolio due to inflation. For a long time, this hasn't really been a focus, inflation's been one to 2%, it hasn't been too high or too significant of a concern, at least in the forefront of investors' minds, but that changed coming out of the pandemic when we saw inflation spike to 8% or more. And so as you think about inflation, obviously that's one key risk is that your portfolio needs to be structured to outpace inflation and outpace your spending.

A lot of organizations refer to that as real growth after distributions. And then one other issue that's popped up on the inflation spectrum and it ties into spending policy and something we want to touch on in a moment too is there are some organizations that have spending policies that have an inflation component. Again, it can make a lot of sense. It's something that we've seen hasn't been a huge issue over the years, but we also saw some organizations find that their spending policy resulted in some pretty outsized spending as inflation spiked and their policy called for them to adjust their spending in response to inflation. And in many cases that created a disconnect between the value of the investment portfolio and the spending rate generated from inflation. So two key risks that we'll talk about as we get into this presentation a little bit further.

Andy Marino:

One other thought adding on that, Heather, you mentioned it earlier, it's not even on the page here, but time horizon risk. So I wonder if poll numbers would've been not necessarily reversed but maybe a little bit different if we had taken that poll at the end of 22 when portfolios were down rather than the end of 23. And that just goes to the fact you mentioned it earlier, we are trying to help clients manage long-term portfolios, thinking decades, but the fiduciary duty is to get together and talk about it every three months and so there's always something new on the rise and volatility wise.

Heather Shanahan:

That's a great point. Let's talk about another form of risk. David, what would you add? Taking a look at liquidity risk?

David Ramsour:

Yeah, I think liquidity risk is important and just for everybody on this call, liquidity risk focuses on the liquidity of your investments and how easily they can be accessed for cash if and when it's needed. So during periods of market volatility, you don't want to be forced to sell something that may be temporarily underpriced when you need cash for operations or for funding. That's why it's important to have a diversified portfolio with assets that are less correlated, meaning that they don't all increase or decrease in value at the same time, but also have varying degrees of liquidity terms IE daily, monthly, quarterly, or illiquid investments while for certain investors having a small portion of the portfolio call it 5% up to 20 to 30% invested in private investments that are illiquid makes some sense because of the higher return expectations and lower volatility of pricing.

It's also very important to make sure that enough of the portfolio is accessible on a daily or monthly basis to meet funding needs. We saw some of the largest university endowment space liquidity concerns in the 2008 2009 time period because they had more than half of their portfolio invested in illiquid private investments when the other or the liquid portion part of the portfolio declined in value by 30 or 40% at that time, they were all of a sudden forced to sell their liquid investments at big discounts because that was their only near term source of cash. The investments they sold would've largely rebounded in the following years, but they were not able to take advantage of that rebound because they had to liquidate those investments for cash needs. That's why it's important to stress test the portfolio to ensure that you've got enough liquidity in times of stress.

Another factor in the discussion is if the institution is the type that also benefits from new contributions such as an endowment versus one that does not, such as a private foundation, an institution is able to take more liquidity risk in the portfolio if there is the prospect of new liquid money coming into the portfolio that may be used to meet short-term funding needs without selling current investments. It's also important in our minds to have some small amount of the portfolio in ultra high quality, ultra short-term fixed income to be the first source of funds when liquidity is needed. So something equivalent to maybe a year's worth of expected spending that allows you to have a little bit longer time horizon as Andy pointed out, to ride some of the ups and downs in the market without being forced to sell something that might be temporarily depressed.

Heather Shanahan:

That's great. Lots of points to consider. And on that note, Andy, you sit in investment committee meetings all over the country with all types of different organizations and institutions and certainly when you look at all these potential factors and you've got a lot of different opinions often at the table, do you see issues with building consensus among committees and boards with what organizations are comfortable with in terms of a risk profile?

Andy Marino:

Sure. Yes. That's one of the big differences with working with groups of people often on a volunteer basis. So everybody's there because they care about the organization and in some capacity they have some professional views oftentimes and those may not necessarily sync up across the board. You can definitely have disagreement and the goal, you mentioned the right word, the goal is to come to a consensus so everybody can agree on certain minimum levels of procedures that they want to carry forward, but it takes some navigating and airing those opinions to see where people differ and work your way through a process where everybody can agree at least on, again, certain basic principles. The biggest one being overall asset allocation and any timing related to that.

Heather Shanahan:

I served on a board several years ago where the spectrum of knowledge on the investment committee was pretty extreme too. So you had folks that were in the industry and were very comfortable with alternative investments in different strategies and then folks that didn't have that same level of experience, they wanted a passively managed portfolio, really strictly driven by cost and thought we should be all in ETFs and mutual funds. So there's a lot of land between here and there. Chris, how do you navigate that? We've got some great tools and resources to help build that consensus in a structured way.

Chris Krakowski:

Yeah, Heather, let's flip to the next slide because one of the tools that we've found to be almost indispensable in dealing with all these types of risks, which again are in many cases unavoidable, you can trade one risk for another, but if you want to have a portfolio that's going to grow over the long term and meet your spending needs and exceed inflation, you're going to have to take risk in some capacity. And so I think that the key that we find to help us build consensus and just set expectations for the future is a very detailed risk assessment survey that we encourage our clients to do and we encourage anyone, any nonprofit to go through a risk assessment survey when you're changing your investment portfolio on an ongoing basis just to make sure that everybody is on the same page. We typically distribute this survey out to investment committee members, board members, even other stakeholders in some cases, whether they're key staff of an organization or others who just have a strong tie to the organization.

And we focus on really a lot of different areas. Obviously we want to define, make sure that everybody gives their input on the return expectation. You might think that as an organization, everybody's on the same page and we hear that a lot. We all agree that we have the same return expectation, we have the same risk tolerance and so forth. But it's always interesting when you get this survey back and you get all the results back that there is always an area of divergence or multiple areas of divergence. And so it's really valuable to, I'd say that if you're looking at all these key metrics here, max drawdown is one that really stands out to me on the upper right hand side. It's great to identify as an organization how much you are willing to lose in order to generate longer term returns in up markets.

It's pretty easy to look at it and say, yeah, we understand we might lose money in down markets though it can be a lot harder to stick to that long-term investment plan and accept the fact that your portfolio might be down 15, 20 plus percent. And this is what really ties things back. Having these responses, having had these conversations is what brings things back and ensures that organizations don't make the decision to take risk off the table at the worst possible time. So again, I think all these topics are really important and all things that every organization should address with their investment committees, with their boards and make sure everybody's on the same page. We do a couple examples of some of the questions we have in our survey. So if we flip to the next page, you'll see this is one that talks about how portfolios perform in different markets and it's something maybe not everyone would think about, but you might just want your portfolio to keep up with the market in all environments. And that can certainly be constructed, but some organizations would rather see their portfolio protect capital in down markets. Markets are down, we're doing better, but at the expense of if markets are up double digits that the portfolio may be lagging that benchmark a little bit. And so again, one key question that we want to look at as we structure portfolios and we think every organization should consider as they structure their portfolios as well.

And then one other example is, and this sort of gets into more of the investment structure of the portfolio, but if you look at equity markets are down 15% for example, followed by a positive 20% year, where do you want to be on that spectrum? It ties back to the previous question, but are you okay being down more in a down market and up more in an up market or vice versa looking to protect capital in certain market environments? So again, very detailed tool that we use and encourage everyone to use as they think about their risk tolerance going forward.

Heather Shanahan:

Excellent. It's helpful to have that objective snapshot. So on the next slide, David, can you kind of walk us through what a summary might look like from this feedback from a committee?

David Ramsour:

Sure. So the key output from our risk preference survey is really something like you see here where we plot each response or each committee member's response on the spectrum so that everybody can see where the group lies, what the average is, but also where there might be consensus and where there might need to be more discussion. The point of this survey is to really dig into several questions that help build the portfolio that meets the unique objectives and constraints of the organization, but also the views and comfort level of the committee. And so when we get this output, we'll sit with the committee and have a discussion about what the survey results are telling us how we think that that means the portfolio should build on things like active versus passive eye tracking error versus low tracking error use of alternatives, et cetera. And we really then focus on questions that we see wide dispersion where we'll have a deeper conversation to try to build consensus.

So an example here might be question two where this question talks about tracking error or volatility of returns around a benchmark. And if the committee is interested in

something that's high tracking error, meaning high active share the potential to add a lot of outperformance versus lower tracking error in the portfolio, meaning there's less of a magnitude of outperformance but also less of a possibility of underperformance. And so here you see quite a lot of dispersion among the respondents. And so what we would do is really hash that out and encourage people to kind of voice their opinions in the committee to really talk through it and build consensus towards how we would structure the portfolio based on this specific question. And again, as we go through the 20 question survey, you'd be surprised how many answers there's complete agreement on something and then how many where there is very wide dispersion. But that's part of our job is to facilitate that conversation so that the end of product is a portfolio that, as I said, meets those objectives and constraints of the organization, but that the committee as a whole is the most comfortable with.

Heather Shanahan:

How often do you do this? You've got turnover by design on your boards and on your committees. How often do you go through the survey process and reassess it every couple of years annually? What's your process?

David Ramsour:

It depends on the circumstances of the organization. I would say by default we do it every three to five years unless there are situations where there's been a change in circumstances, right? If it's a college and they're facing enrollment issues and they may have to be spending more from the portfolio, we may reevaluate this. The other time that dictates when we would do this is if there is a lot of committee turnover because even if we're not going to change things, it helps those newer committee members understand the views of the rest of the group and why the portfolio was built the way that it is.

Andy Marino:

Great. And one more thought on that, Heather would be if it becomes clear over the course of a number of meetings that there's just some pretty wide differences of opinion and or individual louder than other voices that may be representative of the minority of view, but it doesn't sound that way when you're in a series of meetings.

Heather Shanahan:

That's an excellent point and that happens for sure. All right, Landy, since you're talking, we'll go ahead and tee up the next topic over to you then. Let's talk about diversification. We hear 60, 40, 70, 30, 80 20. Are there really differences in these strategies that we're seeing? And if so, what are you hearing? And if not, then what should we be taking a look at and what's the importance of diversification?

Andy Marino:

Yeah, yeah. I mean I don't want to oversimplify this too much, but it's really the most basic principle of portfolio management. You're accessing different kinds of assets that respond differently to different economic circumstances. The old adage, which I

suppose will go out of style at some point is don't put all your eggs in one basket after some series of years. No one will know what that means anymore, but it's the most basic defense against overall market volatility. You don't have every kind of investment responding in exactly the same way. And part of that is just for purposes of the same portfolio can have different needs. Just the basic essence that we've been talking about is that there's an ongoing requirement to distribute funds to support the mission of the organization, but on a long-term basis, you want to also grow. And those are two different things.

So traditionally the 40% of what you're talking about when you say 60 40 is debt instruments, fixed income bonds that produce income on an ongoing and they're less volatile than the rest of the portfolio. And it's a pretty timely topic because in the last couple of years we have exited, at least for now zero interest rate policy. So you went a better part of a decade where the only thing that really happened with bonds was that they didn't change much in price, there wasn't much in the way of income. Well, there is now, and I know Chris is going to talk about this a little bit later right now, you mentioned this right at the top, Heather, that we appear to be in for higher for longer. There was a expectation late last year that interest rates will be coming down fairly dramatically this year that seems to have gotten delayed.

And in one sense, I would say investors should be so lucky if we can maintain this nice mid single digit range without much volatility happening from a price perspective, then bonds will do what they're designed to do. On the other end of the risk spectrum of course, are common stocks that trade on the stock market, so they're marketable. And we can't get a better example as Chris said, than the last couple of years. They can go down pretty dramatically. 2022 ended up in a bear market, but you might call it a fairly benign variety. I think stocks were down 18% or something, but they were down a lot more than that in tri year and it didn't feel like it was going to end down 18 when you were going through it. It never does. And you can look at other times, you go back to 2001, 2002 though 2000 in there, the market was down 40% or something and then it roars back in 2003.

So you have to have an offset to that level of volatility. And then again, we're going to get into more detail on this, but that leads to, those are not the only two things to do. They're not just two tools to use in the toolbox. There are what the industry refers to commonly as alternative investments. They are income producing, return producing kinds of investments that are different in their return behavior than traditional common stocks and bonds that trade on exchanges. It's oftentimes in private markets, private equity or private debt, those sorts of things. And they're different in terms of the timing and the scale of the returns that they produce. But that's a feature, not a bug, right? That's exactly the prospect you want in a portfolio. And they contribute to return goals because they have reasonable return goals that are typically north of what endowments and foundations are spending, but they, to use a technical term, they zig when other things zag.

Chris Krakowski:

Heather, I just tack onto that. I just want to just reiterate one point that Andy made. We're talking hypothetically about risk here and how organizations, what might manage

and view risk, but there's some actionable items I think in the current environment that can help to change the risk profile for organizations. Andy talked about fixed income. I don't think there's a more clear example of an asset class that's changed so dramatically in such a short amount of time. It's hard to remember, but if you think back pre pandemic before in the 2019 range, early 2020, the 10 year treasuries were yielding about 1.5%. That was just a normal environment in treasuries yielding one point a half percent. A couple months later you enter the pandemic. We see a lot of government areas, era stimulus, and you've got 10 year treasuries that are barely yielding a half a percent.

I mean they're barely above zero in many cases. Fast forward just three years and now you have 10 year treasuries that are yielding 4.3% corporate bonds, in many cases, high quality corporate bonds yielding more than 4.3%. And in the lens of a foundation that needs to grow its assets over time or a private foundation for example, that has a 5% spending requirement, in many cases you can pick up pretty close to 5% in a high quality bond. So as you think about risk mitigation, bonds are somewhere you really should be focused. Focused, but again, risk mitigation is key, but also return generation, that's something we haven't gotten out of bonds for a long time. And I would not only rethink as an organization your exposure to fixed income. Heather talked about the standard 60 40, 70 30, the 40, the 30, the 20, those are all proxies for fixed income.

But aside from just your allocation to fixed income, we're encouraging all of our clients to rethink the structure of their fixed income as well because in many cases, fixed income strategy was put into place several years ago in a very different market environment. So you can lock in interest rates at higher interest rates today with more interest rate risk in your portfolios. You can shore up credit quality, still improve your return profile. And then one other area I'd point to is if you have known liabilities as an organization, if you have cash flows that you know are going to come due in the next couple of years, you can construct sort of a liability matching treasury ladder portfolio and basically lock in a return and earn exactly what you need over the exact amount of time to pay those cash flows in 1, 2, 3 years from now. So just one other area to consider from a fixed income standpoint as you can really take a lot of that risk off the table.

David Ramsour:

Yeah, Chris, I think another area that we've seen some interest depending on clients would be in, as Andy mentioned, alternative asset classes. There are several alternative asset classes that can be incorporated into a long-term portfolio to varying degrees. Some clients use most or all of them, some don't use any. It really all depends on the organization's objectives, constraints and comfort level. But if you think about the idea of diversification, ultimately what we're trying to do is smooth the volatility of the market value of that portfolio over time without sacrificing much or any of the return potential. The reason that we want to smooth it is because for an organization that is required to spend a certain amount of that market value, the smoother it is, the less variability that you have in that spending amount, and thus the less variability you have in the either budget support or grants that you make or what have you.

So some clients allocate to private equity and private real estate because the long-term return objective for those asset classes tends to be about 3% higher than the public equity market, but they also tend to reduce volatility of the overall portfolio because they're priced quarterly and they tend to not fluctuate as much in value as other asset classes. These are considered illiquid asset classes, but it's important to note that once a private investment program, whether it be real estate or private equity matures, call it five years out, it does start to regularly return capital, which provides cash for spending needs and reinvestment. These two asset classes, even though I just grouped them together, do compliment each other because they have different return drivers, right? So it's going to contribute to diversification with the traditional part of the portfolio, but also within themselves. Private credit is another alternative asset class where we see a fair amount of client exposure really is a fixed income substitute.

Again, returns are expected to be a few percent higher than public bonds, but private credit tends to be floating rate loans, which almost entirely removes the interest rate risk. So as a result, there's very little market fluctuation, but still a very meaningful current yield which starts almost immediately. So that can also be used to support spending needs or reinvestment. Another alternative asset class that we haven't talked much about would be real assets. So these are things like commodities, infrastructure, agriculture, farmland, et cetera, which tends to have a high correlation with inflation and lower correlation to traditional stocks and bonds. So again, contributes to that overall smoother ride. While real assets aren't typically more than call it 5% of the portfolio, they can play a role as an inflation hedge to help protect the portfolios like we saw in 2022. So if you recall, most things were down, we saw correlation between stocks and bonds go close to one.

And so there were very few areas of the portfolio that could be sold to support spending needs except for our clients that had an inflation hedge in there. If you recall, in 2022, inflation was going up. So when it was time to sell something to meet spending needs, you naturally want to sell what's most overweight. And so having that diversification with real assets for clients, and again, not all alternatives are private or illiquid. So real assets for example, have a range of liquidity depending on what you're investing in, but it can range from daily to monthly all the way till a liquid. So the overall goal for using any of these alternative asset classes is to improve the efficiency of the portfolio of the total portfolio, meaning to increase the expected return or to decrease the expected volatility of the total portfolio market value. Circling back to kind of what we said at the beginning, smoothing out the rise but also not sacrificing returns.

Andy Marino:

David, I'm glad you made that last point about liquidity. I was going to add that I think it connects a couple things you and Chris both talked about. So you just have to decide which risks you're going to take to manage inside of a portfolio. And while private debt and private equity and other strategies like that sound like they are only for the Ivy League universities of the world, there's been a lot of movement with respect to let's call the democratization of those asset classes into vehicles that are a lot more accessible to a lot more investors. There are trade-offs associated with that, the best and the brightest and the largest. They're still probably going to be doing what they're doing in a

way that is not replicable, but it is not inaccessible completely to investors of much smaller portfolio sizes.

David Ramsour:

That's exactly right. And we've seen a movement in the last five years. It used to be just clients that were kind of $50 million and above that could access these efficiently. Now there are vehicles available for all client types, all client sizes, and so that's really helped improve the efficiency of all of our client portfolios.

Heather Shanahan:

Great discussion. I want to remind our audience to please drop any questions that you have in the chat. We'll try to answer those as we go rather than holding them to the end. And on that audience note, I think we're going to go back to another poll as we move to our final topic, and that is spending policies. We were curious to hear from our audience to learn a little bit about your spending policy and that'll help drive our discussion. So let's take a look at our poll questions, two questions. The first, have you recently reevaluated your spending policy? That's a quick yes or no.

Looks like we've got about all the participation here. I'll go ahead and go back to the answers here. So 60% yes, have recently reevaluated your spending policy and I think in light of what we've been talking about today, that makes sense that that is something that organizations would have taken a look at. So let's look at our next question for our audience. What is your spending policy? Three year rolling average five year rolling, average hybrid inflation based or other? And the other category you can include, I don't know. All right, let's go ahead and share the results. I kind of surprising I'm going to assume others probably, again, it may truly be other or some of us just don't know the answer off the top of our head. And I'm also a little surprised that five year rolling average beat out three year rolling average. So interesting. So let's shift here and any immediate feedback from our panelists on those survey results

Andy Marino:

Quickly? I'd say I wonder if fixed percentage rather than of recent market value rather than any rolling time period probably. I would bet that makes up a big percentage of that other

Heather Shanahan:

Category. I bet you're right.

David Ramsour:

Yeah, I was glad to see that there was, of those that are spending a portion of a rolling market value, that more tended to be focused on that five-year period versus three-year period, because that was really something that we saw born out of the financial crisis in 2008, 2009, when basing something on a three-year market value, which is too few data points that could cause a fluctuation in that budgetary support in grants. And so smoothing that out over a longer time period or even we had a lot of our clients move

from what may have been three calendar year market values to 12 quarters, just to smooth that out a little bit. And that's benefited clients over time.

Chris Krakowski:

Yeah. The other one, to your point, Andy, I'm wondering about if there were any just single year end calculations in that other category. And my sense is if there are any out there that have been dealing with that, that's where you've seen a pretty dramatic fluctuation in the spending as an organization. And that can be a real catalyst to reevaluate spending policies. The hybrid, we saw zero for inflation linked, but we did see 10% in hybrid. And there are some Ivy League formulas, for example, like the Yale model that have a hybrid policy and one portion of that hybrid policy is a CPI adjustment. And again, we did see some organizations that saw spending increase that were using that spending methodology saw spending increase at a much faster pace and sort of got out of control and they decided that that was a good time to rethink their spending policy.

So at least from my experience, we're seeing organizations shift back, like David said, toward that longer term rolling average, whether it's 12 quarters or 20 quarters or five years, it tends to link the performance of the endowment with the spending policy, but can create a disconnect if you're a higher ed education institution, for example, that has CPI based expenses like faculty salary, things like that. There's some potential argument for a CPI component to that spending policy. So really just a good opportunity, a great market environment to look back back, test your spending policy and rethink about how you want it to look going forward.

Andy Marino:

One final thought. I'm glad it came up. Sorry David, I'm glad it came up. We're talking in dollars when we're talking about money that's going out the door. And that's really important because the investment industry from a return perspective tends to get fixated on percentages and the nonprofits themselves can get a little bit fixated on percentages, how we talk about spending, but when it turns into dollars, what you're trying to do is get less variability in the amount of money that's available regardless of what the underlying architecture of how we get that number is derived.

Heather Shanahan:

Yeah, that's a great, I had shared with you guys just sitting at the table with a university looking at managing their endowment recently, and a hundred percent of their students receive some form of financial aid and over half of their students are first generation college attendees. I mean, those are real numbers, so it's like a percent all you want, but the reality is we need to make sure that our kids go to school. So how do we manage that effectively? Let's go on for the sake of time to our final two slides as we take a look, we at CAPTRUST conduct an annual survey of endowments and foundations. Typically it's a annual basis. We did an abbreviated version last year at the end of the, I guess fourth quarter just to take a quick flash poll of organizations. And this was the survey result about spending policies from that group. So anybody want to speak to these statistics here?

David Ramsour:

Maybe if we go to the prior slide, it provides a little bit of information about the types of spending policies some of these organizations have. I'm not sure if we're able to pull that up.

Heather Shanahan:

Previous slide. There we go.

David Ramsour:

Yeah, so you can see there's a variation and obviously it depends on the type of institution, endowment versus private foundation. There's obviously different rules around it, but for those that have flexibility, you can see that there's a mix between moving average simple percentage, even a hybrid method as we talked about before. And at the end of the day, there's no perfect answer, broadly speaking, but there could be a perfect answer for this specific institution. But it is important to reevaluate that regularly and make sure that you're really doing what's best for the institution.

Heather Shanahan:

Absolutely. So we're at time, and so we've got a couple key takeaways that are probably pretty obvious if you've joined us all the way through. So number one, risk isn't inherently bad. Create consensus around your tolerance. Do you know how your overall portfolio is constructed? And have an understanding of that and evaluate your spending policy if that's not something that you've done recently, although it looks like the majority of our smart audience has. So that's excellent. So thank you so much to our panelists, Chris, David, and Andy for joining us today. You guys provide great insight as always and great experience and obviously do a fantastic job for your clients. So thank you for being here with us and thanks so much to our audience for participating with us this day. Thanks.

Disclosure: CapFinancial Partners, LLC (doing business as “CAPTRUST” or “CAPTRUST Financial Advisors”) is an Investment Adviser registered under the Investment Advisers Act of 1940. However, CAPTRUST video presentations are designed to be educational and do not include individual investment advice. Opinions expressed in this video are subject to change without notice. Statistics and data have come from sources believed to be reliable but are not guaranteed to be accurate or complete. This is not a solicitation to invest in any legal, medical, tax or accounting advice. If you require such advice, you should contact the appropriate legal, accounting, or tax advisor. All publication rights reserved. None of the material in this publication may be reproduced in any form without the express written permission of CAPTRUST: 919.870.6822 © 2024 CAPTRUST Financial Advisors